

According to the information submitted, X was incorporated on Date 1 under the laws of State. X elected to be treated as an S corporation effective Date 2. On Date 2, stock in X was transferred to Trust 1 and Trust 2. Trust 1 and Trust 2 did not file a timely Electing Small Business Trust (ESBT) election resulting in the termination of X's S corporation status.

X represents that Trust 1 and Trust 2 have, at all times since the transfer of X stock on Date 2, met the requirements of an electing small business trust (ESBT), within the meaning of § 1361(e)(1). X represents that it did not intend for its S corporation election to terminate and the termination was not motivated by tax avoidance. Finally, X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(v) states that an electing small business trust (ESBT) is a permissible shareholder of an S Corporation.

Section 1361(e)(1) defines an ESBT, in part, as a trust if such trust does not have (1) a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary; (2) no interest in such trust was acquired by purchase, and; (3) an election under this subsection applies to such trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of cessation. §1362(d)(2)(B).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consent, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of

time after discovery of the circumstances resulting in the termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based on the information submitted and the representations made, we conclude that X's S corporation election was inadvertently terminated on Date 2 because X had ineligible shareholders. Therefore, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 2 and thereafter, provided that the trustee of Trust 1 and Trust 2 file ESBT elections effective Date 2 for Trust 1 and Trust 2, pursuant to the procedures set forth in § 1.1361-1(m)(2), with the appropriate service center within 60 days of the date of this letter, and provided that X's election to be an S corporation was not otherwise ineffective and was not terminated under § 1362(d). A copy of this letter should be attached to the ESBT elections.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation or the eligibility of either Trust 1 or Trust 2 to be an ESBT.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely,

David R. Haglund

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Office of the Associate Chief Counsel
(Passthroughs & Special Industries)